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UNCLAS SECTION 01 OF 02 HO CHI MINH CITY 001238

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SUBJECT: FOREIGN BANKER EVALUATES VIETNAM'S FINANCIAL SECTOR

REF: Hanoi 3028

¶1. SUMMARY: Vietnam's financial markets are evolving, but the pace of evolution is slow and access to capital is limited for all except state-owned enterprises (SOEs), according to one of the leading foreign bankers in the country. At a recent investment conference hosted by the Ho Chi Minh City People's Committee, the chief executive of Hong Kong Shanghai Bank (HSBC) in Vietnam told an audience of local and international business representatives that investors need to think long-term and keep up with Vietnam's changing regulatory environment when planning investment in Vietnam. END SUMMARY.

¶2. As part of the November 8-9 HCMC Investment Mart, Alain Cany, CEO of HSBC Vietnam and chairman of the European Chamber of Commerce in Vietnam, provided conference participants with a valuable overview of Vietnam's financial sector, which is small but growing. Banks are the main form of financial institution, though less than two percent of Vietnam's 82 million citizens have bank accounts. Vietnam is still primarily a cash-based society; only 60 to 70 percent of business transactions go through the banking system. There is as much as USD 5 billion in savings outside the banking system, which is equal to 25 percent of GDP, Cany said. While only 120,000 credit cards have been issued in Vietnam, there were no credit cards available three years ago and the number of bank accounts have doubled in the same time frame.

¶3. Cany noted that Vietnam's five state-owned commercial banks continue to dominate the banking sector, accounting for 80 percent of total lending, most of which goes to SOEs. Private joint stock banks account for another 10 percent of lending, while foreign and joint venture banks account for the remaining 10 percent. According to Cany, the lack of an effective clearing system and an uneven playing field between domestic and foreign banks are two of the main disadvantages of the Vietnamese banking sector. Movement of funds within the banking system is inefficient; clearing is done manually via messengers. Clearing between institutions in different provinces takes three to four days. Foreign banks still face restrictions on access to domestic deposits and foreign currency funds from local residents and restrictions on branches and off-site automatic teller machines (ATMs).

OTHER FINANCIAL INSTITUTIONS

¶4. Securities markets in Vietnam are also small, but growing, Cany reported. The Ho Chi Minh Securities Trading Center has 30 listed companies, and the Hanoi over-the-counter market had six listed companies as of July. Secondary market trading activities are limited, and the reporting and transparency requirements of the official markets make some companies hesitant to list. However, Cany said company shareholders are beginning to understand how listing can increase liquidity. In October, the GVN raised the limit on foreign ownership in listed companies from 30 to 49 percent. As a result of these positive developments, Cany predicted the markets could double or triple their size in the coming year, albeit from a low level.

¶5. Other capital markets, including the bond market, are predominantly short-term in nature, according to Cany. Banks are relied on to provide medium- and long-term capital, and since most Vietnamese bank deposits are short-term, Cany said there is a danger of foreign currency mismatch, particularly because hedging mechanisms are limited in Vietnam. Vietnam has an underdeveloped bond market; while the GVN has been an active bond issuer, corporate bond issuance is almost non-existent.

REGULATORY ENVIRONMENT

¶6. While there have been positive regulatory developments in the last five years, the environment is still evolving, Cany observed. On the positive side of the ledger, the State Bank of Vietnam is beginning to allow certain types of derivative instruments, including interest rate options, which permits hedging against foreign exchange and interest rate risk. The GVN has also begun to reform its personal income tax structure. It has lowered the personal income tax rate from 50 percent to 40 percent, with further reforms planned. Cany said tax rates must be lowered further because tax evasion is widespread; foreign-invested enterprises and SOEs are virtually the only

taxpayers in Vietnam.

¶7. The U.S.-Vietnam Bilateral Trade Agreement and Vietnam's impending accession to the World Trade Organization have provided and will provide a roadmap for further improvement in the legal system, Cany said. Other improvements include a new Enterprise Law, currently being considered by the National Assembly, and plans to raise the maximum foreign ownership stake in commercial banks to 30 percent in 2006. However, the new Unified Investment Law, also under consideration by the National Assembly, will have a negative impact on the regulatory environment if it is passed in its current form. According to Cany, the law could set Vietnam "back by 20 years."

COMMENT

¶8. Cany's assessment of Vietnam's financial sector mirrors the views of many other HCMC businesspeople. He did not pull any punches, even with top HCMC government leaders sitting in the front row of the audience. His assessment of the draft Investment Law follows on the submission to the GVN of a letter from the American, European, and Australian Chambers of Commerce that strongly criticizes the current draft of the law (reftel).
WINNICK